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No. 91-194

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

QUILL CORPORATION,
Petitioner,
v.
STATE OF NORTH DAKOTA,
by and through its Tax Commissioner,
HEIDI HEITKAMP,
Respondent.

On Writ of Certiorari to the Supreme Court of the State of North Dakota

BRIEF OF CLARENDON FOUNDATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER QUILL CORPORATION

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INTEREST OF AMICUS CURIAE

Pursuant to Rule 36.2 of this Court, the Clarendon Foundation respectfully submits this brief amicus curiae in support of Petitioner, Quill Corporation. Written consent to the filing of this brief has been granted by counsel for all parties. Copies of the letters of consent have been lodged with the Clerk of this Court.

The Clarendon Foundation is a non-profit, non-partisan legal foundation concerned with significant legal issues related to the Constitution, democratic government and the attendant rights and responsibilities of citizenship. The

Foundation participates in various forums in cases where the resolution of constitutional issues may be aided by historical and philosophical analyses. The Clarendon Foundation is committed to an on-going review of the basic tenets of our constitutional government, in the spirit of George Mason's admonition that ". . . no free government, or the blessings of liberty, can be preserved to any people, but . . . by frequent recurrence to fundamental principles." The instant case raises questions of paramount significance to the public interest. We believe the Foundation's perspective will complement Petitioner's brief and assist the Court in the resolution of these issues.

SUMMARY OF ARGUMENT

The proper resolution of this case requires only that the Court stand on the sound rationale of *National Bellas Hess*. *National Bellas Hess* affirmed the exclusive power of Congress "[t]o regulate Commerce . . . among the several States" and restricted a state's authority to levy a use tax collection duty on out-of-state mail order vendors unless the vendors have a physical presence within the state. The *National Bellas Hess* rationale is as sound today as when pronounced in 1967, and has not been diminished in any degree by the recent trend toward reckoning state taxing jurisdiction in terms of the "economic presence" of the out-of-state company. Whatever value the "economic presence" test may have for deciding other jurisdiction-to-tax issues, the application of that test here is indefensible.

The requirement of physical presence has not been rendered obsolete either by modern technology or by changes in Commerce Clause or Due Process Clause formulae in the years since *National Bellas Hess*. To the contrary, physical presence as a concept retains the fundamental logic which has always commended it, namely, that corporations not physically situated within the state as a political subdivision do not enjoy the attendant

political privileges. As Chief Justice Stone wrote for the Court, "To the extent . . . the burden of state regulation falls on interests outside the state, it is unlikely to be alleviated by the operation of those political restraints normally exercised when interests within the state are affected." *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 767-68 n.2 (1945). Such disparity of political power is the *raison d'etre* for commending exclusive power over interstate commerce to the Congress. This case provides the Court with the opportunity to affirm this proper limitation on a state's regulatory power over an out-of-state business with no physical presence in the taxing jurisdiction.

ARGUMENT

I. PHYSICAL PRESENCE AS AN ANALYTICAL MODEL FOR ASSESSING STATES' REGULATORY AND TAXING JURISDICTION HAS BEEN FIRMLY ESTABLISHED.

The decision of the North Dakota Supreme Court challenges the continuing vitality of the physical presence test adopted by this Court in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), and applied in numerous other cases. In *National Bellas Hess*, Illinois sought to impose a use tax on an out-of-state vendor, whose only contacts with the State of Illinois consisted of the periodic mailing of catalogs and advertising flyers to Illinois residents and the delivery of goods to state residents by mail or common carrier. 386 U.S. at 754. The vendor did not maintain an office or have any sales personnel or agents there, nor did it own any property in the state. *Id.* Notwithstanding the vendor's lack of physical presence, Illinois demanded that the vendor collect a use tax from its Illinois customers.

The Court refused to uphold Illinois' assertion of authority, declining "to repudiate totally the sharp distinction" between mail-order firms with physical property in

the regulating state and those lacking in-state property. *National Bellas Hess*, 386 U.S. at 758. According to the Court, the Commerce Clause requires " 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' " *Id.* at 756 (quoting *Miller Bros. Co. v. State of Maryland*, 347 U.S. 340, 344-45 (1954)). The Court concluded that it was "difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved." *Id.* at 759.

National Bellas Hess stands as the counterfactual to other cases in which the Court—drawing the same "sharp distinction"—has upheld the power of a state to impose liability upon an out-of-state seller to collect a local use tax where the vendor *does have* a physical presence within the state. A collection duty on a mail-order firm with in-state retail stores was held constitutional in *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373 (1941). Similarly, the Court upheld the imposition of a use tax collection duty in *General Trading Co. v. State Tax Comm'n.*, 332 U.S. 335 (1944), where a mail-order firm employed an in-state traveling sales force. And in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), the Court held that a mail-order firm's solicitation of orders through an in-state sales force of ten individuals created the necessary jurisdictional predicate for the state. The Court reaffirmed the principles of *National Bellas Hess* in *National Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551 (1977), in which it upheld a state's imposition of a use tax collection duty on a mail-order firm with two offices in the regulating state.

Absent physical presence, a state's exercise of regulatory jurisdiction over an out-of-state entity can be sustained only when the state regulation is designed to protect state residents. Note, *Collecting The Use Tax On Mail Order Sales*, 79 Geo.L.J. 535, 544 (1991). For example, in *Travelers Health Ass'n v. Virginia*, 339 U.S.

643 (1950), this Court upheld state regulation of an out-of-state mail-order insurance company because the "state has a legitimate interest in all insurance policies protecting its residents against risks, an interest which the state can protect even though the 'state action may have repercussions beyond state lines. . . .' " *Id.* at 647, *citing Osborn v. Ozlin*, 310 U.S. 53, 62 (1940). *See also Alden's Inc. v. Packel*, 524 F.2d 38, 44 (3d Cir.), *cert. denied*, 425 U.S. 943 (1976) (rejecting due process challenge to state's usury laws because the state had an interest in protecting residents from an out-of-state company's excessive interest rates). Such cases are not exceptions to Congress' exclusive power over interstate commerce, but rather, must be seen as an exercise of a state's inherent power to protect its own citizens within the state.

By contrast, North Dakota's imposition of a tax collection duty on an out-of-state company selling office supplies serves no such prophylactic purpose and fulfills no such police duty. The tax collection law serves one, and only one, end—the generation of state revenues. It is wholly unrelated to the state's concern for its citizens' welfare and safety.

Physical presence is the "nexus" between the state and the out-of-state vendor that justifies the tax collection duty. The vendor's duty, in turn, is its *quid pro quo*, its "fair share of the cost of local government whose protection it enjoys" and for which the state "can ask return." *National Bellas Hess*, 386 U.S. at 756 (citations omitted). *See also National Geographic Soc'y*, 430 U.S. 551 (1977).

The North Dakota Supreme Court, finding that this Court would today overrule *National Bellas Hess*, rejected the position that Quill Corporation's lack of physical presence in North Dakota was determinative. The state court's position follows the view taken by some courts and academics that the required nexus between the

buyer's state and an out-of-state seller should be economically rather than physically based. *See, e.g., American Refrigerator Transit Co. v. State Tax Comm'n*, 395 P.2d 127 (1964); P. Hartman, FEDERAL LIMITATIONS ON STATE TAX AND LOCAL TAXATION, 39-40, 438-39, 628, 630-32 (1981); McCray, *Overturning Bellas Hess: Due Process Considerations*, 2 B.Y.U.L.Rev. 265 (1985). The rationale for this argument is that an out-of-state vendor whose products are consumed in the market state derives benefits from the market state in addition to those ordinarily predicated upon a firm's physical presence within the state's boundaries. Technological innovations, it is said, have increased an out-of-state vendor's access to the economic benefits of the market state to such a level that the rationale of *National Bellas Hess* is no longer valid. *See North Dakota v. Quill Corp.*, 470 N.W.2d 203, 225 (1991).

This approach is fundamentally flawed. The soundness of the Court's rationale in *National Bellas Hess* is supported by (1) a review of the historical circumstances which necessitated adoption of the Commerce Clause; and (2) an analysis of the physical presence test in the context of the delicate tension between state sovereignty and interstate commerce. As demonstrated herein, a careful look at the nature of state sovereignty shows that the "benefits" analysis is actually ancillary to a much more fundamental rationale for the physical presence requirement.

II. THE JUSTIFICATION FOR THE COMMERCE CLAUSE: THE TENSION BETWEEN STATE SOVEREIGNTY AND FEDERAL JURISDICTION OF INTERSTATE COMMERCE.

The efficacy of the physical presence test is underscored when the circumstances which necessitated the creation of the Commerce Clause are considered. History teaches that the *Articles of Confederation* failed principally because the states were functioning at radical cross-

purposes in areas affecting interstate commerce. In *The Federalist*, for example, Alexander Hamilton warned that "the interfering and unneighborly regulations of some states," if not restrained, could lead to the conditions then paralyzing the German Empire, whose commerce was "in continual trammels from the multiplicity of duties which the . . . states exact upon the merchandisers passing through their territories." THE FEDERALIST No. 22 (A. Hamilton).

James Madison's concerns on this score were equally grave:

> A very material object of this power [to regulate commerce] was the relief of the States which import and export through other States, from the improper contributions levied on them to the latter. Were these at liberty to regulate the trade between State and State, it must be foreseen that ways would be found out to load the articles of import and export, during the passage through their jurisdiction, with duties which would fall on the makers of the latter and the consumers of the former. We may be assured by past experience, that such a practice would be introduced by future contrivances; and both by that and a common knowledge of human affairs, that it would nourish unceasing animosities, and not improbably terminate in serious interruptions of the public tranquility.

THE FEDERALIST No. 42 (J. Madison).

In response to these concerns, the Commerce Clause was fashioned to neutralize the "fruitful source of contention" which conflicting state commercial practices had spawned. THE FEDERALIST No. 7 (A. Hamilton). On this score, there was virtually universal consensus among the participants of the Constitutional Convention. Their contemporaneous writings "stressed the point that every one was in agreement as to the merit of this feature of the Constitution, and they seem to have been stating a fact." Abel, *The Commerce Clause In The Constitutional*

Convention And In Contemporary Comment, 25 Minn. L. Rev. 432, 444 (1941). Accordingly, the Framers established, in remarkably unequivocal language, that "[T]he Congress shall have Power . . . To regulate Commerce . . . among the several States." U.S. CONST. art. I, § 8, cl. 3.

This Court's decisions have affirmed repeatedly that the fundamental purpose of the Commerce Clause is to preserve national political and economic union. *See, e.g., H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 533-35, 537-39 (1949) (the Commerce Clause, and this Court's decisions thereunder, are intended to preserve "the solidarity and prosperity of this Nation" by ensuring that "our economic unit is the Nation"). The Framers intended to prevent a recurrence of the "economic Balkanization that had plagued relations among . . . the States under the Articles of Confederation." *Hughes v. Oklahoma*, 441 U.S. 322, 325-26 (1979).

This history is significant to modern Commerce Clause analysis, for it makes clear the Framers' understanding that as to matters affecting commerce among the states, Congress should exercise exclusive authority. Such grant of authority suggests, however, that as to matters within the jurisdiction of the state, the states were to maintain their independent power.

The unavoidable tension between the states' desire to promote their distinct and parochial interests, and the national government's interest in maintaining fluid channels of interstate commerce, is a dynamic which is no less at work today than it was when the Commerce Clause was created. This dynamic was succinctly characterized by the U.S. Court of Appeals for the Third Circuit in *Alden's, Inc.*

> No state interest rates so high in the state scale of values as the state sovereign's fisc. At the same time no extraterritorial manifestation of sovereignty, except possibly arrest, is quite so offensive to common notions of its territorial limits.

Id. at 43-44.[1]

The instant case concerns this very tension. The physical presence requirement preserves the equilibrium between Congress' constitutional authority over interstate commerce and the states' inherent authority over matters within their territory. Yet, for reasons amplified in Section III, the decision of the North Dakota Supreme Court threatens this constitutional balance. As this Court observed in *National Bellas Hess*,

> if the power of [the states] to impose use tax burdens on [an out-of-state vendor] were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision. . . .

386 U.S. at 759. The Commerce Clause was designed to protect out-of-state entities against precisely this result.

III. THE PHYSICAL PRESENCE TEST OF *NATIONAL BELLAS HESS* IS ANALYTICALLY SOUND.

An analysis of the philosophical foundations of state authority demonstrates plainly that the physical presence criterion applied by the Supreme Court in *National Bellas Hess* is wholly appropriate and, indeed, that its rationale is not correlated in any degree with technologi-

[1] A further point must made in this connection. The federal preemption reflected in the Commerce Clause applies no less to *state courts* than to state legislatures. Neither state organ has the authority to effectuate regulations which extend beyond the reach of the state's regulatory or taxing jurisdictional authority. Yet, the decision of the North Dakota Supreme Court is a plain instance of judicial legislation in an area where only Congress is authorized to regulate.

cal developments. The North Dakota Supreme Court's error lies in its premise that a state's providing protections and benefits to its citizens is the sole precondition for the state's jurisdiction over the recipients of such protections and benefits. This premise is incomplete and thus flawed; the overlooked complement of the benefits criterion actually provides the fundamental justification for the physical presence requirement.

The philosophical underpinnings of the rights and privileges of citizenship in a state are deeply rooted in the great social contract theorists of the Enlightenment. *See* J. Locke, SECOND TREATISE OF CIVIL GOVERNMENT (Bobbs-Merrill 1962) (1st ed. 1690); T. Hobbes, LEVIATHAN (Indianapolis 1958) (1st ed. 1651); J. Rousseau, THE SOCIAL CONTRACT (F.M. Watkins ed. 1954) (1st ed. 1762). *See also* A. Kelly & W. Havbison, THE AMERICAN CONSTITUTION: ITS ORIGINS AND DEVELOPMENTS 94 (3d ed. 1963); J. Kettner, THE DEVELOPMENTS OF AMERICAN CITIZENSHIP: 1608-1870, 44 (1978). According to these theorists, whose influence upon the Framers is undisputed, the moral authority of the state derives from an implicit contract among the members of the state. The power of the sovereign arises from the consent of its citizenry. Indeed, Locke's consent theory served as a cornerstone for various written compacts central to the Nation's political and legal development, including the Mayflower Compact, colonial charters, and the Declaration of Independence.

The justification for state sovereignty relies upon two criteria, not equal in weight. The less important of these—and the focus of the lower court's decision—is the protections and benefits which citizenship in a state affords. Although this criterion is significant, it is not the primary philosophical justification for state regulation. Rather, to legitimize such regulation, the state must rely upon a second criterion, namely, whether the citizens affected by the state's laws have an influence in

the political processes of the sovereign. The overwhelming importance of this latter criterion is highlighted in the case where a state enacts ineffective or improvident laws: the mere fact that a law may not adequately protect or benefit the citizenry does not of itself invalidate the law, provided the procedure of its enactment accords with the principles of representative democracy (*i.e.*, the second criterion is satisfied). Hence, the Court must "view[] with suspicion any state action which imposes special or distinct burdens on out-of-state interests unrepresented in the state's political process." L. Tribe, AMERICAN CONSTITUTIONAL LAW 409-10 (2d ed. 1988).

In Locke's view, one of the most important attributes of representative government is the ability of the constituency "to alter the legislative [power], when they find the legislative act contrary to the trust imposed in them." J. Locke, OF CIVIL GOVERNMENT 192 (Best Printing Co. ed. 1943). Indeed, Locke viewed this ability as a feature of all valid governments:

> And thus the community perpetually retains a supreme power of saving themselves from the attempts and designs of anybody, even of their legislators, whenever they shall be so foolish or wicked as to lay and carry on designs against the liberties and properties of the people.

Id.

The justification for state intervention in the affairs of a corporate citizen is no less than that for natural persons: corporations receive protections and benefits from the state and, by virtue of their physical presence, have an influence in the political processes of the sovereign.

In the case at bar, however, these two criteria utterly diverge. Whatever measure of economic benefit Quill Corporation may receive from the commercial environment maintained by the State of North Dakota, it has no involvement in the processes of the sovereign which correlates in any degree whatsoever with the influence

which local commercial entities possess. Quill Corporation is not incorporated or otherwise physically located within any municipal subdivision, county or state legislative district within North Dakota, nor is it indirectly present through agents or salesmen. Quill Corporation thus lacks those affiliating circumstances in North Dakota that would permit it to reap the benefits of state citizenship and participate in the state's political processes. Quill Corporation's sole contacts in North Dakota are its customers, and that relationship is mediated by the U.S. Postal Service and other traditional common carriers. Neither Quill Corporation's customers nor the communications media can be said in any meaningful sense to represent Quill's political interests in North Dakota.

The fact that Quill Corporation lacks this voice exposes the flaw in the economic presence argument. This can be illustrated by analogy to the philosophical justification for a state's authority over visitors, who are unrepresented in the regulatory state's own political processes.

On its face, it may appear that a benefits criterion serves as the predicate for regulating a visitor's activities. This is incorrect. The justification underlying the authority of a state law enforced against visitors derives from the concept of private property, basic to social contract theory and firmly ingrained in the consciousness of the Framers of the Constitution.

Under social contract theory, one of the original rights arising from the initial contract is the sovereignty of an individual over his or her own property. Similarly, the state, as the collective agent for its residents, establishes territorial boundaries. On this basis, it can impose regulations on visitors to the state not unlike, in the abstract, the demands that an individual can make of those who enter his or her private property.

The range of conditions a state can impose on visitors includes subjecting them to the state's regulatory and

taxing practices. Even though it is true that visitors receive, during their stay, the protections and benefits of the state, this criterion does not provide the essential justification for the state's subjecting visitors to the same laws as citizens. Rather, that justification is that visitors have come within the state's territorial boundaries and must observe the rules and regulations applicable therein. It is this consideration, rather than a benefits criterion, which provides the most coherent basis for delimiting a state's regulatory reach. *See Burnham v. Superior Court of California*, 495 U.S. 604 (1990) (plurality opinion).

The physical presence criterion of *National Bellas Hess* logically flows from this analytical model of state regulatory authority. When a corporation actually establishes a physical presence in a state, in the form of regional offices, a sales force or retail outlets, it is in the same position as a citizen or visitor. It is within the territorial jurisdiction of the state, and may be required to enforce the state's use tax within that jurisdiction.

This, however, is not such a case. Neither Quill Corporation nor its agents has ingressed any property under the jurisdiction of the State of North Dakota. It cannot legitimately be said to have come within North Dakota's regulatory jurisdiction.

In sum, the physical presence doctrine is grounded in the view that the authority of the state derives from the consent of the governed and the principle of private property. The economic presence model invoked below, by comparison, relies upon a benefits criterion which is insufficient, in and of itself, to justify state regulatory jurisdiction outside the state's territorial boundaries. Accordingly, the North Dakota Supreme Court's analysis is invalid.

CONCLUSION

For the foregoing reasons, the judgment of the North Dakota Supreme Court should be reversed.

Respectfully submitted,

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